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Significance of treasury stock [News items]

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The Significance of Treasury Stock

IN the somewhat remote past the term treasury stock was used to mean either stock authorized and unissued, or stock once issued for value and subsequently reacquired, depending on one's concept of the term. Time, thought, and a better understanding generally of accounting terms have served to clarify this conflict of usage, so that to-day treasury stock has come to mean but one thing, namely, the capital stock of a corporation re-acquired by the corporation after once having been issued for value.

Consideration of the matter of treasury stock need involve little discussion of the motives which prompt the acquisition. The effect of such procedure rather is of the more importance. The law generally does not require that a company acquiring its own capital stock shall cancel that stock. Legally the purchase by a corporation of its own stock does not effect a reduction of its capitalization, or its capital.

Economically there is at least a suggestion of reduction in the capital since, in cases where the stock is purchased, assets of the business, and usually cash, have to be taken to pay back to certain stockholders, capital contributed or earned by them either in theory or fact. Whether the stock was issued originally for bona-fide values or values based on fiction and convenience, seems to have little bearing on the effect when the stock is reacquired. Any stock outstanding represents, both legally and economically, share ownership in the net assets of the corporation, on whatever basis the net asset value may be fixed. The act by the corporation of taking up any of its shares must of necessity be accompanied by the complementary act of parting with or reducing some of its assets. Except the corporation elects to cancel the shares so acquired, they are substituted in the list of assets in place of those surrendered in exchange for the stock.

Here, then, is a sort of wheel within wheel; the carrying of an asset which is offset by stock, the proprietary value of which rests in the company's net assets exclusive of the treasury stock. But, it is contended, the treasury stock may be sold and replaced by cash. This is all true enough, as is also the rejoinder that if the limit of authorized capital has not been reached new stock might be sold at the same rate. The fact remains that the condition of the treasury would be the same prior to the sale whether the stock sold is called unissued stock or treasury stock. And, apparently, treasury stock is a sort of myth which is made possible by an offsetting credit in the capital stock account.

There can be no objection to carrying an account on the financial books for treasury stock any more than for unissued stock. As a matter of record and convenience, it seems good practice to do so. Treasury stock frequently is received as a result of donation. A separate account on the books facilitates keeping track of it. Likewise, such stock is sometimes bought by a corporation for purposes of resale or distribution as a bonus or award in connection with other profit-sharing schemes to employees. Under such conditions, with activity in the transactions giving rise to frequent charges and credits, it would be obviously unwise to mix such transactions with the capital stock accounts.

Again, treasury stock may be acquired as a means of reducing capital to conform to the needs of the business without the legal formality of obtaining authorization from the state. This expedient has the advantage of keeping the stock available for re-sale in the event conditions change and it becomes desirable to again increase the capital fund required for the needs of the business. Under such circumstances a treasury stock account on the books is not only convenient but logical.

Setting up treasury stock on the books in order to facilitate keeping track of it and placing a value on it for balance sheet purposes are two different things. One may concur in the propriety of the former and have grave doubts as to the latter. Fundamentally treasury stock measures, so long as it is held in the treasury, an effective reduction of the capital fund employed in the business. The figure at which it is carried is but the measurement of this reduction.

The value of treasury stock is entirely potential. The potentiality lies in the possibility of selling or transferring it to someone at a price. Strictly speaking, it has no investment value to the corporation even though it is sometimes classified among investments. Marketability alone gives the only semblance of authority for such classification. Any theory of return on investment falls of its own weight when the absurdity of paying dividends on treasury stock is considered. Safety of principal must be admitted if one admits the existence of principal. But the search for value seems to end with the discovery that there is no value except that which the possibility of sale suggests. All this may be maintained notwithstanding the fact that treasury stock is sometimes included with investments in outside companies, presumably only, however, where the amount involved is small and its inclusion does not practically distort the value of the investments when considered in their relation to the total assets.

The fact that treasury stock is frequently acquired at some figure per share other than par need not stand in the way of treating it in the balance sheet as a deduction from capital stock. Obviously, under such circumstances the surplus must be adjusted to the extent of the difference between par and the acquisition price, crediting surplus where acquired below par; charging surplus if acquired at a premium. The adjusted treasury stock will then be on the same basis as the capital stock and the proper deduction may be effected.

In no sense is this an argument in favor of applying or washing the treasury stock against the capital stock outstanding and leaving no trace of the potential asset on the balance sheet. Nor is it to be taken as favoring the elimination of a treasury stock account on the books. It is rather an attempt to raise for consideration the question of whether balance sheets would not more nearly represent the facts where treasury stock is involved therein were such stock to be shown as a deduction from the capital stock outstanding rather than as an asset.

One who considers the matter philosophically cannot escape the conviction, it seems, that with regard to the treatment of treasury stock many of those who have to do with the preparation of balance sheets have fallen somewhat thoughtlessly into a practice which has the sanction of considerable usage instead of the authority of sound theory.

Mr. J. R. Wildman delivered an address before the New York State Society of Certified Public Accountants, at the Yale Club, New York, Monday, May 7, 1923, on "Organization for Accountancy."

Mr. Wildman also presented a paper before the New York chapter of the National Association of Cost Accountants, at the Machinery Club, New York, May 15, 1923, on "Cost Accounting in Relation to Business Cycles."